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OFFICE OF CONSUMER ADVOCATE

DIRECT TESTIMONY

OF

FRANK BODINE

IN RE: LIBERTY UTILITIES (MIDSTATES NATURAL GAS) CORP. d/b/a LIBERTY UTILITIES
DOCKET NO. RPU-2016-0003

November 7, 2016

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Q: Please state your name, occupation and business address.

A: My name is Frank Bodine. I am a Utility Specialist at the Office of Consumer Advocate. Our office address is 1375 East Court Avenue, Des Moines, Iowa 50319-0063.

Q: Will you please state briefly your qualifications?

A: I graduated from Lincoln University in 1975 with a Bachelor of Science degree in Economics, from the University of Missouri in 1979 with a Master of Arts degree in Economics, and from the University of Southern California in 1989 with a Master of Science degree in Management. I was employed by the Institute for Energy Analysis in Oak Ridge, Tennessee as a Research Associate from June 1979 to September 1982. My duties included the research and analysis of energy related topics such as industrial energy use and conservation potentials, state/federal cooperative data projects, and the production, distribution and consumption of natural gas and electricity. After that, I was employed by the state of Illinois as a Senior Natural Gas Analyst at the Illinois Department of Energy and Natural Resources. I was also employed by the Illinois Commerce Commission, holding several positions and working on topics such as rate design, class cost of service studies, telecommunications, and economics issues. During a portion of that time, I was an instructor in the Business and Economics Department at Lincoln Land Community College,

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Springfield, Illinois. After working for the State of Illinois, I worked for Quantitative Solutions Incorporated, a consulting firm dealing mainly with telecommunications. In 2002, I started work with the Iowa Utilities Board (IUB or Board), as the Manager of the Policy Development Section, and in 2010, I became employed by the Office of Consumer Advocate (OCA).

Q: What is the purpose of your testimony?

A: I will address the cost-of-service and rate design issues discussed in the testimony of Company witness Timothy S. Lyons. My testimony includes Schedules A through E, which are attached.

Cost of Service Study

Q: Have you reviewed the cost of service study prepared by Company witness Timothy S. Lyons?

A: Yes. The Company has used a type of cost of service study that has been used by the Board in several other rate cases, however the Company allocated most of the capacity costs to residential and commercial customers in their cost of service study. The Company accomplished this by excluding industrial customers from the design-day calculations. The Company justified this allocation based on the fact that all of its industrial customers are categorized as interruptible customers. Based on the premise that these customers could be interrupted on a peak day, the Company argues that they should not be included in peak day designs or plans.

Q: Do you agree with the allocations made by the Company that are based on a design-day basis?

A: No. While the theory of excluding interruptible customers from design-day (peak-day) calculations seems correct at first glance, the theory does not match the facts in this case. The reality is that these customers have never been interrupted since Liberty purchased the gas system in 2012. *See* Schedule A. The Company does not have records for interruptions before 2012, so the lack of interruptions could go back much further. Even though the time period covered in the Company records is relatively short (five years), it includes periods of severe winter weather and extremely cold weather late in the heating season when one would normally expect interruptions to occur. If the interruptible customers were going to be interrupted, it should have happened during these time periods. No interruptions of these customers indicates that even though the industrial customers are technically categorized as "interruptible" they are in actuality interruptible customers in name only. In the absence of any significant recurring interruptions, the service provided by Liberty to these customers is really more firm than interruptible.

Q: What are the implications of the industrial/interruptible customers rarely, if ever, being interrupted?

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A: For the cost study, it means that some of the demand related costs that Liberty allocated to the various customer classes based on their demands during peak periods should be allocated to the industrial class of customers instead of being allocated only to Liberty's residential and commercial customers. Lyons Exhibit TSL-7, page 1 of 4, shows that industrial customers have 60.0% of average daily usage on the Liberty system, but they have been given a 0% allocation of design-day, or peak usage, resulting in an overall 31.8% demand allocator. If Industrial customers were included in Design Day calculations (*see* Confidential Schedule B) the demand allocator for Residential customers would decrease from 42.06% to {[redacted]}; for Small Commercial customers it would decrease from 8.87% to {[redacted]}; for Medium Commercial customers it would decrease from 17.27% to {[redacted]}; and for Industrial customers it would increase from 31.80% to {[redacted]}. With a zero allocation to industrial customers for peak day usage even though these customers are using the system during peak periods, the result is that industrial customers are being subsidized by residential and commercial customers. The system is clearly large enough and has sufficient capacity to allow industrial customers to be served without interruption during peak periods, and it would be unreasonable to use cost allocation factors that ignores this.

Q: How does the change in the demand allocator impact the Revenues at

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Equalized Rates of Return shown in Lyons Exhibit TSL-6, page 1 of 102?

A; Under the Company's proposed revenue requirement (excluding PGA costs), the recommended increase for Residential customers (*see* Confidential Schedule C) would decrease from 47.2% to {[redacted]}; for Small Commercial customers it would decrease from 44.8% to {[redacted]}; for Medium Commercial customers it would decrease from 75.0% to {[redacted]}; and for Industrial customers it would increase from 43.9% to {[redacted]}. Clearly, there is a subsidy under the Company's proposal, and subsidies of this type are inconsistent with cost based rates and should be avoided.

Q: Are you recommending additional changes to the Company's cost of service study that would impact the demand allocator?

A: Yes. OCA witness Kebede is recommending the inclusion of Keokuk Steel's 2015 data for ratemaking purposes. Based on this recommendation I believe the data regarding Keokuk Steel should also be included in the cost of service study. Inclusion of Keokuk Steel's 2015 data (*see* Confidential Schedule D) will result in the allocation factor for Residential customers decreasing to {[redacted]}; for Small Commercial customers it will decrease to {[redacted]}; for Medium Commercial customers it will decrease to {[redacted]}; and for Industrial customers it will increase to {[redacted]}.

The inclusion of Keokuk Steel's data (*see* Confidential Schedule E) will

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result in an overall increase of {[redacted]}, an increase to Residential customers of {[redacted]}; for Small Commercial customers the result would be an increase of {[redacted]}; for Medium Commercial customers the result would be an increase of {[redacted]}; and for Industrial customers the result would be an increase of {[redacted]}.

Q: What is your recommendation regarding the allocation of demand costs to the various customer classes?

A: I recommend that all classes of customers, including Industrial customers, be assigned some portion of the peak-day demand costs in the cost of service study. Industrial customers (including Keokuk Steel) should receive an allocation of the demand costs since they are receiving service and using the system during peak demand periods. Allocating some peak-day demand costs to all customers who take gas and use the system during peak periods will result in a more equitable allocation of costs to the various customer classes. It will also help mitigate the very large proposed increase to residential and commercial customers. If a full allocation of peak day costs for industrial customers is implemented as shown in my Confidential Schedule C, the percentage increase to industrial customers would constitute rate shock. Therefore, I recommend that the demand allocation to the industrial class result in an increase that is no more than the system-wide increase determined by the Board.

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Q: Do you have other concerns regarding the Company's cost of service study?

A: Yes, the Company calculated two different estimates of customer costs--"basic" customer costs and "fully allocated" customer costs (Lyons Exhibit TSL-10, pages 21-22). The monthly "basic" customer cost estimate for Residential customers is $12.58; for Commercial-Small it is $20.62; for Commercial-Medium it is $137.48; and for Industrial it is $33.30. The monthly "fully allocated" customer cost estimate is much higher: for Residential customer it is $27.61; for Commercial-Small it is $41.69; for Commercial-Medium it is $249.93; and for Industrial it is $183.42. The method used by Liberty to calculate the fully allocated customer cost includes fixed costs that have not traditionally been included in determining the monthly customer charge. Including these costs increase the monthly customer cost estimates by a large amount. It also results in monthly customer charges that are significantly higher than those charged by Iowa's other investor-owned utilities, which are set forth below.

	Liberty Proposed	Liberty (current)	MEC	IPL	BH
Small Vol. (residential)	$27.61	$7.95	$10.00	$13.00	$18.25
Medium Vol. (commercial)	$41.69 to $249.03	$13.00	$55.00	$30.00	$29.00 to $75.00
Large Vol. (industrial)	$2,145.50	$1,400.00	$55.00	$225.00	$200.00

The reason for including the additional cost categories is that the Company

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wants to move to a straight-fixed-variable rate design (discussed below) and is providing a cost estimate for that type of rate design. The arithmetic may be accurate, but the concept is faulty (discussed below). I do not believe the fully allocated customer cost estimates using a straight fixed variable approach should be used to set rates.

Rate Design

Q: What is the Company's rate design proposal in this proceeding?

A: The Company is asking the Board to approve a straight-fixed-variable proposal that would increase the customer charge in three phases, elimination of its two-step consumption rates, and the addition of a new commercial class.

Q: What revenue requirement data have you used in your rate design proposal?

A: I have used the Company's revenue requirement data for comparison purposes. In my discussion on rate design I have also included rate proposals if the Board decides the revenue requirement should be less than the Company proposal. My use of the Company data does not mean I endorse or approve of the Company's requested revenue requirement.

Q: Do you agree with the Company's proposed increase to the customer charge?

A: No. As I mentioned earlier, the Company has calculated two different customer

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costs: the first one is "Basic" Customer Costs, and the second is "Fully Allocated" Customer Costs. In the first proposal, the Company's cost calculations would support a modest increase in the customer charges. As I discuss later, I recommend customer charges based on these cost estimates. Under the alternative proposal, the Company proposes to dramatically change the way customer charges are calculated by moving to a straight-fixed-variable approach. The proposed straight-fixed- variable approach would enable Liberty to recover a disproportionately large share of its costs through the fixed monthly customer charge and a correspondingly smaller share through the volumetric rate. The alternative proposal is a substantial increase in the costs recoverable through the fixed monthly customer charge and results in customer charges that are well above the estimated customer costs and are out of sync with the monthly customer charges of the other Iowa rate-regulated gas utilities. For Liberty's Residential customers the customer charge would increase from $7.95 per month to $27.61 per month; for Small Commercial customers it would increase from $13.00 per month to $41.69 per month; for Medium Commercial customers it would increase from $13.00 per month to $249.93 per month; and for Industrial customers it would increase from $1,400 per month to $2,145 per month. The increase in the customer charges is not cost justified, and there is no reason to increase the customer charges to the level recommended by the

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Company.

Q: Do you have other concerns regarding the Company's proposal to increase customer charges?

A: Yes, as stated above, the Company's alternative proposal is a move towards a straight-fixed-variable rate design that focuses on recovering more costs in the fixed charge rate component. The general theory is that if you place more cost recovery in a fixed charge instead of the volumetric rate, revenues will be more stable. While revenue stability is obviously important to Liberty (and reduces its risk), there are other important considerations in designing rates. Perhaps the most important involves sending customers the right price signals regarding the efficient use of natural gas. For example, increasing the fixed monthly customer charge (and, thus, reducing the revenue collected through volumetric rates) reduces the customer's incentive to pursue and take advantage of energy efficiency measures. Encouraging customers to efficiently use energy is an important policy of the state of Iowa. It is the reason that Iowa's utilities are required to offer comprehensive energy efficiency programs to its customers. Liberty's proposal to increase the fixed monthly customer charge and reduce the volumetric charge is inconsistent with the state policy, and it undermines its own energy efficiency programs.

Mr. Lyons does not address overall policy objectives and how they

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should be balanced. A move towards a straight-fixed-variable rate design is certainly not cost justified when compared to the customer cost estimates provided by the Company. Without adequate cost justification, the Board is left with a policy decision regarding straight-fixed-variable rate design, without a thorough analysis and discussion of this policy and the ramifications of its use. A dramatic change in rate design such as this should only be implemented after the Board has received much more information than what has been presented by the Company.

The Company's proposal also contradicts cost of service principles established in Board rules. The administrative code for electric service (199 IAC-20.10(2)e.) states that, "Customer cost component estimates or allocations shall include only costs of the distribution system from and including transformers, meters and associated customer service expenses." That means that only customer related costs, not other fixed costs, may be included in cost estimates. While this rule explicitly applies to electric service and rates, the theory and rationale equally apply to natural gas rates. It is clear that the intent was to include only customer related costs in the customer charge, not load up the customer charge with other types of costs. The Company should be required to justify a move to straight-fixed-variable rate design for natural gas utilities in the light of rules prohibiting other utilities from doing so. It has not done so.

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Q: What is your recommendation regarding the Company's proposal for customer charges?

A: I recommend that the customer charges be set at the Interim Rate level: $10.39 for Residential, $16.99 for Small Commercial, and $25.00 for Medium Commercial customers. The customer charge for Industrial customers should not be increased, but rather be set at the level that existed prior to this rate case ($1,400).

The interim increase in the customer charge for Residential customers and Small Commercial customers are similar (in percentage terms) and should be the upper limit for any increase in the customer charge. A $25.00 customer charge for Medium Commercial customers would be similar to the customer charge for commercial customers of other utilities. The customer charge for Industrial customers prior to the current rate case was well above the cost estimate provided by the Company in this case and should not be increased. The remainder of the approved revenue requirements should be collected through the volumetric charge.

I also recommend that the Company's straight-fixed-variable proposal be rejected. An increase in the customer charges under the Company's straight-fixed-variable proposal are not cost justified and would place a large amount of short-run fixed costs in the customer charge without an analysis of long-run impacts such as customer usage and efficiency efforts.

Q: Under the Company's straight-fixed-variable rate design proposal, the Company proposed the elimination of its two-step consumption rates. What is your recommendation regarding the change in rate structure?

A: As stated previously, I recommend the straight-fixed-variable proposal be rejected, but the elimination of the Company's two-step consumption rates should be accepted. The use of the two-step rate design has the effect of penalizing low-usage customers by having them pay a larger percentage share of the proposed increase. A more fair approach is to have a single volumetric, or consumption, rate.

Q: What is your rate design recommendation if the Board approves a lower revenue requirement than what the Company proposed?

A: I recommend that the customer charges be set at the levels I discussed above, and that the remainder of the revenue requirements be collected through the volumetric charge.

Q: The Company's proposal would establish two new Commercial rate classes to replace the existing Commercial class. Do you agree with the Company's proposal?

A: The Company's proposal is based on cost differences within the existing commercial class. Due to the cost differences shown in the Company's

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testimony, a majority of commercial customers would fall into the proposed Small-Commercial class, with the remainder in the Medium-Commercial class (*see* Direct Testimony of Timothy S. Lyons, page 7, Figure 3). The cost differences shown by Mr. Lyons seem reasonable and the Company's proposal to establish two new Commercial rate classes should be adopted.

Q: Does this conclude your direct testimony?

A: Yes, it does.

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STATE OF IOWA)
) **SS: AFFIDAVIT OF FRANK BODINE**
COUNTY OF POLK)

I, Frank Bodine, being first duly sworn on oath, depose and state that I am the same Frank Bodine identified in the foregoing Direct Testimony; that I have caused the foregoing Direct Testimony to be prepared and am familiar with the contents thereof, and that the foregoing Direct Testimony as identified therein is true and correct to the best of my knowledge, information and belief as of the date of this Affidavit.

/s/ Frank Bodine
Frank Bodine

Subscribed and sworn to before me, A Notary Public, in and for said County and State, this 7th day of November, 2016.

/s/ Craig F. Graziano
Notary Public

My Commission expires: June 14, 2017

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OCA BODINE DIRECT EXHIBIT
SCHEDULES A–E

OF

FRANK BODINE

IN RE: LIBERTY UTILITIES (MIDSTATES NATURAL GAS) CORP. d/b/a LIBERTY UTILITIES
DOCKET NO. RPU-2016-0003

November 7, 2016

OFFICE OF CONSUMER ADVOCATE
DATA REQUEST

DATE	:	August 23, 2016
DOCKET NO.	:	RPU-2016-0003
COMPANY	:	Liberty Utilities (Midstates Natural Gas) Corp. d/b/a/ Liberty Utilities
WITNESS	:	Timothy Lyons
SUBJECT	:	Cost Allocations
REFERENCE	:	Lyons Direct Testimony, page 19

8. On page 19, lines 11-13, it states that the Industrial class is not included in the Design Day calculations because they are interruptible customers. List each instance and duration of the interruptions for each industrial customer during the past 10 years.

Response:

The Company has not called for an interruption of its interruptible customers since acquisition of the service territory in 2012. Records regarding interruptions prior to 2012 are not available.

NOTE: In the event the response to this data request contains confidential information, do not simply mark the entire response or attached document(s) confidential. Please highlight, or otherwise identify, the specific information that is claimed to be confidential.

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SCHEDULE B

PAGE 1 OF 1

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SCHEDULE C
PAGE 1 OF 1

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SCHEDULE D
PAGE 1 OF 1

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PAGE 1 OF 1

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